Economic Outlook

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Where's the growth? That's the concern of those who doubt the ability of the U.S. economy to expand through next year without a downturn. The sources of their concern are not hard to identify. If housing starts are not responding to relatively low mortgage rates, if auto sales are propped up only by unsustainable incentive financing programs, if indicators of future capital spending are flashing warning lights, and if fiscal policy may (finally) become less stimulative, where will the growth come from to sustain the recovery? The answer lies primarily in moderate increases in consumer spending, improvement in the U.S. trade position, and the absence of an inventory correction.

The slowdown is evident in the paltry 2.1% growth in real GNP from the third quarter of 1984 to the third quarter of 1985, the latest period for which complete data are available. Consumer spending added 2.5 percentage points to this growth, and capital spending added another percentage point. Real GNP growth was so slow because the movements in inventories and net exports provided substantial negative offsets to the growth in other GNP components. Without these offsets, real growth would have been in excess of the 3.5% contribution provided by consumer spending and business capital spending.

The United States is now in the fourth year of economic recovery. As a comparison, real GNP growth in the fourth and fifth years of the recovery in the second half of the 1970s averaged 3.5% per year. Consumer and business spending together contributed 2.5 percentage points to this growth, and a favorable movement in the U.S. trade position added another 1.4 percentage points. Interestingly, the dollar fell roughly 20% during the late 1970s, the same depreciation as has occurred since the dollar peaked last year. This depreciation will likely lead to a narrowing of the trade deficit (in real terms), with marked improvement during the second half of this year.

In 1986, real consumer spending and business capital spending are expected to provide about 2.5 percentage points to GNP growth, similar to the experience of the late 1970s. Then, as now, some analysts contended that the excessive burden of consumer indebtedness would keep the brakes on consumer spending. In fact, consumer spending kept expanding until credit controls caused it to collapse. Even with the heightened emphasis on containing Federal spending, the government sector will provide a significant contribution to real GNP growth in 1986, as it did last year. In addition, net exports will be less of a drag on growth this year, while the change in inventories will add to rather than detract from the economy's growth. The net result is that real GNP is expected to rise 3.6% in 1986 from the 1985 level, versus an estimated 2.4% increase in 1985. (On a fourth-quarter to fourth-quarter basis, real GNP is expected to rise 3.9% this year, compared to an estimated rise of 2.8% last year.)

In more general terms, despite the considerable problems in particular sectors and industries (farming, steel, textiles, etc.), the economy has a lot going for it this year. Interest rates are lower than year-ago levels, the dollar has declined considerably from its peak, and inventories are generally in better alignment with sales. These developments have set the foundation for improved economic growth in 1986.

Bernard Schoenfeld

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Economic Forecast

Percent Changes at Annual Rates

	Actual				Forecast				Actual	Forecast	
				1985				1986	1983-	1984-	1985-
	I	II	III	IV	I	II	III	IV	1984	1985	1986
Gross National Product	6.9	4.5	5.8	6.6	7.2	8.1	8.6	8.3	11.0	5.8	7.2
Real GNP	3.7	1.1	3.0	3.4	4.0	4.2	3.9	3.5	6.6	2.4	3.6
GNP Price Deflator	3.0	3.3	2.9	3.0	3.1	3.7	4.5	4.7	4.0	3.3	3.5

	Actual	Forecast	Actual	Forecast	
	1985:III	1985: IV	1983-1984	1984-1985	1985-1986
Consumer Spending	6.8%	3.9%	8.7%	6.5%	6.8%
Durable Goods	23.7	-19.1	14.3	8.8	3.1
Nondurable Goods	1.9	7.8	6.8	4.7	6.5
Services	6.0	8.5	8.6	7.3	8.0
Business Capital Spending	3.7	10.2	20.1	11.2	8.0
Structures	1.7	5.7	17.0	15.0	5.4
Equipment	4.8	12.8	21.7	9.2	9.4
Residential Investment	9.7	8.2	17.8	3.5	5.5
			1984	1985	1986
Change in Inventories	$0.2b.	$18.0b.	$67.1b.	$13.1b.	$21.3b.
Net Exports of Goods and Services	$-87.8b.	$-87.0b.	$-59.2b.	$-71.9b.	$-82.3b.
			1983-1984	1984-1985	1985-1986
Government Purchases	20.4%	2.7%	9.0%	10.0%	8.1%
Federal	36.0	-5.1	9.9	11.6	7.0
Defense	23.6	9.0	9.9	10.9	9.2
Other	82.8	-38.0	9.8	13.8	0.2
State & Local	9.6	9.1	8.4	8.8	8.9
Corporate Profits Before Tax	0.4*	3.5*	15.9	-5.0	8.5
Corporate Profits After Tax	0.6*	3.4*	10.9	-2.9	7.7
Plant and Equipment Expenditures	1.1	0.1	16.3	8.4	5.5
Real Final Sales#	5.0	1.9	4.5	4.0	3.5
Real Disposable Personal Income	-4.5%	1.6	5.7	1.6	3.2

Economic Indicators	Recent Data			Actual	Forecast	
	Sept.	Oct.	Nov.	1983-1984	1984-1985	1985-1986
Consumer Price Index**	3.6%	3.6%	3.6%	4.0%	3.8%	4.6%
Producer Price Index for Finished Goods**	-13.2	19.2	7.2	1.7	1.8	3.5
Industrial Production	-0.2	-0.3	0.4	11.5	3.0	2.8
Retail Sales##	2.2	-4.2	1.1	10.5	6.8	5.0
				1984	1985	1986
Auto Sales (millions of units, a.r.)	14.4	9.6	9.8	10.4	11.0	10.4
Housing Starts (millions of units, a.r.)	1.61	1.76	1.55	1.75	1.72	1.64
Unemployment Rate	7.1%	7.1%	7.0%	7.5%	7.2%	6.5%
Merchandise Trade Deficit (a.r.)	$186.6b.	$137.4b.	$164.2b.	$123.3b.	$147.0b.	$160.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

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#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).

$b. = billions a.r. = annual rate F = Forecast